Shangri-la Development Bank Limited: Rating placed on watch with negative implications[1]

October 3, 2023

Summary of rating action

INSTRUMENT/FACILITY	ISSUE SIZE	RATING ACTION
Issuer Rating	NA	[ICRANP-IR] BB+@*; placed on watch with negative implications.

*@ indicates Rating Watch with Negative Implications

Rating Action

ICRA Nepal has placed the issuer rating assigned to Shangri-la Development Bank Limited's (SADBL) on "Watch with Negative Implications" as indicated by [ICRANP-IR] BB+@ (pronounced ICRA NP issuer rating double B plus @). Issuers with this rating are considered to have a moderate risk of default regarding timely servicing of financial obligations. The rating is only an opinion on the general creditworthiness of the rated entity and is not specific to any debt instrument. The sign of + (plus) or – (minus) appended to the rating symbol indicates their relative position within the rating categories concerned.

Rationale

The rating watch with negative implications is mainly on account of the recent deterioration in the SADBL's assets quality profile with higher than industry average non-performing asset (NPA) levels (3.06% as of mid-July 2023 against 2.49% for the industry) and spike in 0+ days delinquencies (~32% as of mid-July 2023). The recent slippages have impacted the bank's solvency profile (net NPA/ net worth) which has slipped to ~11% and remains on a higher side among the industry peers as of mid-July 2023. All these have impacted the bank's capitalisation which has moderated to CRAR of 12.4% and tier-I capital of 9.43% as of mid-July 2023. Further, the rising cost of deposits (amid declining low-cost current and savings accounts (CASA) proportion) has translated into higher base rate, weakening the bank's competitive positioning. Coupled with moderation in non-interest income and rising credit cost, SADBL's profitability has also moderated accordingly despite gradual improvement in operating expense ratio. Furthermore, ICRA Nepal takes note of the regulatory restriction on the class-B development banks in areas such as loans against hypothecation of stocks and receivables, foreign currency-based transactions (such as import letter of credits), etc. These factors coupled with relatively small scale of operations, compared to the class-A commercial banks offering wider range of services with finer lending rates, remains a long-term credit negative for class B banks.

However, the rating continues to derive comfort from the bank's adequate track record (operating since 2006) along with a presence across the country (112 branches as of mid-July 2023). The bank's growing franchise base and experienced management team have helped it register healthy business growth in the past few years while maintaining a granular credit portfolio (~13% among top-20 borrower group as of mid-July 2023). This cushions the asset quality and the capitalisation concerns to some extent. Additionally, improved deposit granularity to ~15% among top 20 depositors as of mid-July 2023 from ~19% as of mid-January 2022 also remain positive. SADBL's adequate liquidity as of mid-July 2023 also remains a comfort.

Going forward, SADBL's ability to improve its asset quality profile, contain its delinquencies and maintain adequate capital and liquidity cushion to withstand probable shocks will remain key rating sensitivities. Moreover, maintaining its competitive positioning in the industry by improving its deposits profile and profitability profile will remain among other key rating drivers.

1 Please refer here for details on rating watch and its meaning/implications

Key rating drivers

Rating strengths

Adequate track record with diversified presence across the country – Operating since 2006, SADBL has an adequate track record of operations in the Nepalese banking arena. The bank also has an adequate presence across the country through its 112 branches as of mid-July 2023, supporting the bank's portfolio growth along the retail and SME segments. The diversified branch network has supported good growth - deposit and credit growth at CAGR of ~31% each in the last four years ending mid-July 2022 (higher than banking industry[2] growth of ~16% and ~18% respectively); notwithstanding marginal degrowth in FY2023.

Granular credit portfolio, improved deposit granularity – SADBL continues to maintain good portfolio granularity wherein the top-20 borrower groups accounted for ~13% of the total credit portfolio as of mid-July 2023 (13% as of mid-January 2022, last rating exercise). This provides some comfort amid deterioration in its asset quality profile. Further, the deposit concentration has also decreased to ~15% among top-20 depositors as of mid-July 2023 from ~19% as of mid-January 2022; which remains a comfort against the concerns on stability of the funding profile amid the volatile banking sector interest rates.

Rating challenges

Weak asset quality with high delinquency –SADBL's gross NPLs of 3.06% as of mid-July 2023, remains higher than the development bank industry average of 2.49%, raising asset quality concerns for the bank. The concerns are further exacerbated by the bank's high delinquency levels, with 0+ days delinquency of ~32% of total loans (including NPLs) as of mid-July 2023 from ~16% as of mid-January 2023. Ability of the bank to control the incremental asset quality will have a direct bearing on its profitability, solvency, and capitalisation profile.

Moderate capitalisation profile with lowering cushion at tier-I level – SADBL reported a moderate capital to risk-weighted assets ratio (CRAR) of 12.40% as of mid-July 2023, albeit improved from 11.59% as of mid-July 2022 supported by capitalization of internal accruals amid credit degrowth. Tier I capital also remains moderate despite improving marginally in FY2023 from FY2022 level for same reasons. A thin capital cushion amid asset quality pressure will remain key rating monitorable.

Declining CASA led to high cost of deposits – In line with the industry, SADBL continues to report moderation in its CASA deposits to ~23% as of mid-July 2023 (development banks' industry average of 25%). The increasing proportion of term deposits has led to an increased cost of deposits which has resulted in a comparatively higher base rate for the bank. The bank's ability to improve CASA and hence lower its costs of deposits would remain crucial to improve its competitiveness in the industry going forward.

Moderation in profitability profile – The bank reported moderation in its profitability indicators due to increased credit costs amid deterioration in its asset's quality and moderation in non-interest income levels despite good NIMs and improving operating expenses levels. SADBL's return on assets (RoA) and return on net worth (RoNW) reduced to 0.58% and ~8% in FY2023 from 0.98% and ~13% respectively in FY2022. Going forward, the bank's ability to maintain adequate NIMs and manage the assets quality would have a strong bearing on its profitability profile.

Intense competition from larger commercial banks with a wider range of services – As per the regulatory provisions, class-B banks are restricted to undertake certain activities that are allowed for class-A commercial banks viz. credit secured only against hypothecation of stock and receivables, opening of foreign currency-denominated letter of credit/ guarantees, etc. These provisions erode the competitive positioning of the development banks such as Shangri-la vis-à-

[2] Industry data of development banks remain distorted by mergers of many peers with class A commercial banks and hence overall banking industry data taken for comparison.

vis the commercial banks with higher capital, stronger brand and branch network, larger customer base, a wider range of services and finer lending rates. This remains a long-term negative for the development bank industry.

Analytical approach: For arriving at the ratings, ICRA Nepal has applied its rating methodologies as indicated below.

Links to applicable criteria:
Bank Rating Methodology
Issuer Rating Methodology

Link to the last rating rationale:
Rationale- Shangri-la Development Bank Limited-Rating Surveillance March 2022

Bank profile

Established in December 2006 as a regional development bank, Shangri-la Development Bank Limited (SADBL) underwent a merger with another regional development bank (Bageshwori Development Bank) on July 13, 2014, to become a national level development bank. The merged operations were continued under the name of Shangri-la Development Bank. Later, SADBL acquired Cosmos Development Bank, a one district level development bank on July 14, 2017. SADBL's corporate office is located at Baluwatar-4, Kathmandu. The share capital of the company is held by the promoter and public shareholders in the ratio of 51:49. Mr. Suyog Shrestha is the bank's Chief Executive Officer.

SADBL has a presence throughout the country through its 112 branches as of mid-July 2023. The bank has a market share of ~9.2% in terms of deposit base and ~8.9% in terms of advances of the development banks' industry as of mid-July 2023. SADBL reported a profit after tax (PAT) of NPR 344 million during FY2023 (35% YoY decline) over an asset base of NPR 58,733 million as of mid-July 2023. SADBL's CRAR was 12.4% (with tier-I capital of 9.4%) and gross NPLs stood at 3.06% as of mid-July 2023.

Key financial indicators

YEAR ENDED	Mid-July 2020 (Audited)	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Provisional)
Net Interest Income – NPR Million	1,050	1,207	1,691	1,804
Profit before tax – NPR Million	268	589	741	500
Profit after tax – NPR Million	191	410	527	344
Loans and advances – NPR Million	23,926	36,294	43,240	42,093
Total assets – NPR Million	32,898	47,837	59,822	58,733
OPERATING RATIOS				
Net Interest Margin/Avg. Total Assets	3.55%	2.99%	3.14%	3.04%
Non-interest Income/Avg. Total Assets	0.58%	0.58%	0.40%	0.26%
Operating Expenses/Avg. Total Assets	2.35%	2.12%	1.87%	1.72%
Credit Provisions / Avg. Total Assets	0.88%	0.58%	0.30%	0.73%
PAT / Avg. Total Assets	0.65%	1.02%	0.98%	0.58%
PAT / Net Worth	5.75%	11.69%	13.34%	7.86%
Gross NPLs	1.13%	1.40%	1.39%	3.06%
0+ days delinquencies	30.24%	15.76%	22.95%	32.02%
CAPITALISATION RATIOS				
Capital Adequacy Ratio	13.62%	11.77%	11.59%	12.40%
Tier-I Capital	12.35%	10.52%	8.61%	9.43%
Net NPLs/Net Worth	4.36%	7.20%	6.74%	10.97%
COVERAGE & LIQUIDITY RATIOS				

YEAR ENDED	Mid-July 2020 (Audited)	Mid-July 2021 (Audited)	Mid-July 2022 (Audited)	Mid-July 2023 (Provisional)
Total Liquid Assets/Total Liability	25.65%	23.16%	25.29%	25.97%
Total Advances/Total Deposits	81.79%	84.70%	82.83%	80.16%

Source: *Company Data*

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About ICRA Nepal Limited

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